

EXXON COMPANY, U.S.A.

IBLA 89-322, 90-30

Decided February 21, 1991

Consolidated appeals from decisions of the Director, Minerals Management Service, affirming the denial of requests for transportation allowances for leases maintained under section 6 of the Outer Continental Shelf Lands Act. MMS 88-0178-OCS; MMS 89-0011-OCS.

Affirmed.

1. Oil and Gas Leases: Royalties: Generally--Outer Continental Shelf Lands Act: State Leases: Generally

The holder of oil and gas leases issued for lands on the Outer Continental Shelf by the State of Louisiana and maintained under sec. 6 of the Outer Continental Shelf Lands Act must pay royalties in accordance with the provisions of the original State leases. Where the leases were issued on the 1942 Louisiana State lease form, which provides that the lessee pay to the lessor "sums equal to the value * * * at the well [of one-eighth of all gas produced and saved or utilized], provided no gathering or other charges are made chargeable to lessor," the lessee is not permitted to deduct transportation allowances from the amount on which royalty is calculated.

APPEARANCES: Charles L. Katz, Esq., Houston, Texas, for appellant; Peter J. Schaumberg, Esq., Geoffrey Heath, Esq., and George Fishman, Esq., Office of the Solicitor, Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE HUGHES

Exxon Company, U.S.A. (Exxon) appeals from two decisions of the Director, Minerals Management Service (MMS), dated November 18, 1988 (MMS 88-0178-OCS), and July 26, 1989 (MMS 89-0011-OCS). The Director's decisions upheld rulings by the Chief, Royalty Valuation and Standards Division (RVSD), denying Exxon's requests for transportation allowances on various of its leases for periods between 1985 and 1988.

All of these leases were issued by the State of Louisiana on its 1942 lease form prior to enactment on August 7, 1953, of the Outer Continental

Shelf Lands Act (OCSLA), 43 U.S.C. §§ 1331-1356 (1988). 1/ Under OCSLA, Congress essentially provided the Outer Continental Shelf (OCS) lands were subject only to Federal leases. However, previously existing state leases issued by the States of Texas and Louisiana were maintained as Federal leases pursuant to section 6 of OCSLA, 43 U.S.C. § 1335 (1988). 2/ See, generally, Sonat Exploration Co., 105 IBLA 97, 99 (1988). The leases in question here were all so maintained.

On July 29, 1987, Exxon submitted three letters to the Chief, RVSD, requesting authorization to "reduce the royalty basis for offshore gas production by the transportation charges incurred by Exxon to move the royalty portion of gas and/or gas products to a point remote from the above indicated lease, unit agreement area, unit participating area, or communitized agreement area." On March 2, 1988, the Chief, RVSD, denied Exxon's requests, stating:

[OCSLA] included Sections 6 and 7 to accommodate leases issued by the states in the areas of dispute, offshore Louisiana and Texas. The leases identified above were originally issued by the State of Louisiana under its 1942 lease form which states, in part, ". . . nor shall any deductions whatsoever be made chargeable to lessor" Accordingly, these seven leases are Section 6 leases and are not eligible for an approved transportation allowance.

Exxon appealed this decision to the Director, MMS, who issued his decision (MMS 88-0178-OCS) affirming RVSD's decision on November 18, 1988.

In the meantime, on July 29, 1988, Exxon requested a transportation allowance for leases for the period May 1, 1987, through February 29, 1988. This request was denied by RVSD on October 19, 1988. Exxon appealed to the Director, who issued his decision (MMS 89-0011-OCS) affirming RVSD's denial on July 26, 1989.

The Director's decisions held that section 6 of OCSLA mandates that the language of the lease controls royalty payments and does not permit transportation costs to be deducted from the amount from which royalty is calculated. While he acknowledged that section 8 leases are entitled to transportation cost allowances pursuant to Departmental regulations, he rejected Exxon's assertion that regulations providing for transportation

1/ The dates of issuance of the various leases are not apparent from the record. The parties agree, however, that all of these leases contain the terms of the 1942 Louisiana State Lease Form.

2/ Section 6 of OCSLA, 43 U.S.C. § 1335 (1988), authorizes the Secretary of the Interior to validate any state-issued mineral lease covering submerged lands of the OCS that meets the requirements of that section. Section 8 of the Act, 43 U.S.C. § 1337 (1988), authorizes the Secretary to issue mineral leases for any submerged lands of the OCS not covered by leases meeting the requirements of section 6.

allowances for leases issued pursuant to section 8 of OCSLA should control royalty payments on section 6 leases. He held that, under section 6(b) of OCSLA, 43 U.S.C. § 1335(b) (1988), as applied by Departmental regulation 30 CFR 256.79, the royalty provisions of the state-issued leases control.

The Director referred to the following terms from the 1942 Louisiana lease form, pertaining to payment of royalties:

Should * * * gas * * * be produced in paying quantities on the premises hereunder, then the said lessee shall deliver to the lessor as royalty, free of expense:

* * * * *

One-eighth (1/8) of all gas produced and saved or utilized, delivery of said gas to be understood as made when same has been received by the first purchaser thereof. Or lessee may in lieu of said gas delivery, and at its option, pay to lessor sums equal to the value thereof at the well, provided no gathering or other charges are made chargeable to lessor; provided further that the price paid lessor for said gas shall not be less than the average price then current for gas of like character or quality delivered to the pipe line purchaser in that field.

(Quoted in Nov. 18, 1988, decision at 4-5 (emphasis supplied in part)).

In interpreting these terms, the Director relied upon this Board's opinion in Ocean Drilling & Exploration, 21 IBLA 137 (1975), holding that, in the absence of a contrary State court decision or overriding Federal law or regulation, it is appropriate to defer to the consistent interpretation of the state lease form by a state administrative agency. The Director found that the Louisiana State Mineral Board (LSMB) has consistently interpreted the words "gathering or other charges" in the 1942 lease to exclude

a deduction for transportation costs, as demonstrated by two resolutions that LSMB made on July 16, 1959, and May 13, 1965, discussed below. Under the terms of Exxon's lease, the Director found the phrase "no gathering

or other charges" unequivocal in its intent to restrict deductions from royalty basis, such that no deduction for transportation costs could be allowed. Accordingly, he affirmed the denial of such deductions.

Exxon has requested that its appeals from the two decisions of the Director be consolidated. As these appeals present identical issues for resolution, Exxon's request is granted.

Exxon (appellant) argues that established Louisiana law and policy require us to interpret the royalty clause in the 1942 lease to compel MMS to grant transportation deductions as requested. It argues that our decision in Ocean Drilling & Exploration Co., *supra*, does not compel us to accept the views of the LSMB, as we held in that case that MMS was not bound by "ambiguous" views of LSMB. Appellant contends that the fact that the 1942 lease includes an express prohibition of the deduction transportation costs for oil, but does not include a similar express prohibition of

transportation costs for gas, signifies that transportation costs for gas were not intended to be prohibited. Appellant also argues that Departmental regulations mandate that value for royalty purposes includes deductions for transportation, citing 30 CFR 206.152 (1988).

In its answer, MMS responds that, under section 6 of OCSLA, the terms of the 1942 Louisiana State lease form as interpreted by the LSMB govern whether Exxon is entitled to transportation allowances; that the gas royalty clause in the 1942 lease specifically prohibits such allowances; that this lease has consistently been interpreted to prohibit such deductions by LSMB, the state agency charged with its administration; and that permitting transportation deductions under these circumstances would violate the intent of section 6 of OCSLA, which is to leave the state lessees in relatively the same economic position as they had previously enjoyed.

[1] Initially, we reject appellant's argument that regulations providing transportation allowances are applicable to the leases in question. The regulation cited by appellant, 30 CFR 206.152 (1988), was promulgated effective March 1, 1988, and applies only "prospectively to gas production on or after" that date. 53 FR 1230 (Jan. 15, 1988); Arco Oil & Gas Co., 115 IBLA 393, 395-96. Thus, it does not apply here. In any event, the regulations contain provisions specifically governing section 6 leases, from which it is clear that lease terms regarding royalties take precedence over other Departmental regulations:

All regulations in the part, insofar as they are applicable, shall supersede the provisions of any lease which is maintained under section 6(a) of [OCSLA]. However, the provisions of a lease relating to * * * royalties * * * shall continue in effect, and, in the event of any conflict or inconsistency, shall take precedence over these regulations. [Emphasis supplied.]

30 CFR 256.79(a). OCSLA repeatedly distinguishes between maintenance of existing state leases validated under section 6 and new Federal leases to be issued by the Department under section 8 and accords different treatment to both. We find no indication in the legislative history of OCSLA that Congress intended in that Act to allow transportation deductions under section 6. See Sonat Exploration Co., 105 IBLA 97, 113-14 (1988).

[2] Rather, it is evident from the statute that Congress intended the parties to retain the terms of the pre-existing leases concerning the deductibility of expenses from royalty value. It is established that the royalty provisions of a state lease validated and maintained under section 6 of OCSLA will govern the determination of the royalty due to the United States. Sonat Exploration Co., 105 IBLA at 114-17; Superior Oil Co., 31 IBLA 127, 132 (1977). The legislative purpose behind the enactment of section 6 was to leave the state lessees in roughly the same economic position as they had previously enjoyed. Ocean Drilling & Exploration Co. v. United States, 600 F.2d 1343, 1348 (Ct. Cl. 1979). This was accomplished by leaving the royalty provisions of the pre-existing agreement in force in the new Federal lease. Thus, any entitlement to a transportation deduction arises, if at all, from the terms of the lease.

The LSMB has consistently interpreted the 1942 lease provision as providing that transportation costs may not be deducted in calculating royalty due. On July 16, 1959, it adopted a resolution expressly stating that none of the lease forms used by it since its creation or theretofore utilized by the State of Louisiana, including perforce the 1942 lease form, "authorize[d] or permit[ted] any charge or charges to be made against the State of Louisiana for a portion or a proportionate part of the expense incurred for transporting, storing, barging, or otherwise disposing of or delivering oil, gas and other minerals produced." On May 13, 1965, LSMB adopted another resolution revising its opinion as to the terms of the 1928, 1930, 1936, 1948, and 1962 lease forms, but maintaining its position that the 1940 and 1942 lease forms did not allow deduction of transportation costs. ^{3/}

The LSMB is an agency of the State of Louisiana. See Louisiana Land & Development Co. v. State Mineral Bd., 229 F.2d 5 (5th Cir. 1956). It has historically enjoyed supervision of oil and gas leases on State public lands, including authority to determine that the terms of such leases are complied with. 30 La. Rev. Stat. Ann. § 129(A) (West 1989). LSMB has authority to determine boundaries, character, title, location, and other matters relating to land. 30 La. Rev. Stat. Ann. § 131 (West 1989). In the past, it has reviewed and approved all bonuses, rentals, and royalties due from State leases. Ocean Drilling & Exploration Co., 21 IBLA at 140-41. While LSMB thus enjoys broad authority, this authority is not exclusive. See State v. Texas Co., 205 La. 417, 17 So.2d 569 (1944). Nevertheless, it is established that its opinion on royalty matters will not be set aside in the absence of variant or divergent views, either by it or by other State officers empowered to interpret the law, such as the State Attorney General. Sonat Exploration Co., supra at 118; Ocean Drilling & Exploration Co., 21 IBLA at 140-41.

Appellant argues that LSMB's interpretation "has often been contradicted by the opinions of the State Attorney General," but cites only an article by Assistant Louisiana Attorney General James E. Phillips, Jr., entitled The 1966 State Lease Form, 14 Mineral Law Institute 3 (1967). This article discusses the changes made from the 1962 Louisiana lease form to the 1966 lease form. The article states, as to royalties for gas, that

^{3/} LSMB determined in 1965 that, under the 1928, 1930, 1936, 1948, and 1962 lease forms, transportation costs could be deducted if the facts of the case disclosed that such costs were extraordinary in nature and are necessary to obtain a market for the production in question. Ocean Drilling & Exploration Co., 21 IBLA at 140.

We note that the Director's decision contains a misstatement on this question, indicating that LSMB "further resolved on May 13, 1965, that no transportation costs were deductible under the 1942 Louisiana State Lease Forms unless the lessee can prove that the charges were extraordinary" (Decision at 6). To the contrary, as noted above, LSMB did not include the 1942 lease form in the group that it held would allow transportation charges, if extraordinary.

"[t]he [Mineral Board] settled a troublesome question by specifically providing that lessee may deduct costs incurred for compressing gas at a point in or adjacent to the field." Appellant asserts that the 1966 lease form was modified to provide, in effect, that transportation costs for gas were deductible. 4/

Appellant submits that this article "clarified retrospectively the interpretation of earlier lease forms," presumably including the 1942 form, such that deduction of compression and transportation costs would be allowed, but gathering and production costs would be prohibited. Appellant suggests that the amendment of the 1966 form demonstrates that there was confusion about what the 1942 form provided, and that this confusion was resolved in favor of the State's allowing transportation deductions for gas produced under the 1942 leases. We disagree.

The adoption of a new form in 1966 containing substantially different language than that contained in the 1942 lease form cannot be presumed to have superseded the plain, contrary terms of the 1942 form. See Sonat Exploration Co., supra at 118. While LSMB might have resolved a troublesome question by amending the 1966 form, there is no indication that it did so in a way which retroactively altered the terms of the 1942 form, which presented no ambiguity. 5/ Appellant has not alluded to any leases issued

4/ According to Phillips, LSMB provided that transportation costs for gas would be treated the same as for oil, and that such treatment allowed these costs to be deducted. Id. at 8-9. MMS suggests that the change in the

1966 form did not guarantee that transportation costs for gas were deductible, but only "costs incurred for compressing gas at a point in or adjacent to field." It is thus not clear that Phillips' conclusion that the 1966 form ensured the deductibility of all transportation costs is well founded. However, it is unnecessary to resolve this point, as we find no indication that the changes adopted for the 1966 form evinced an intention to reinterpret the 1942 form.

5/ The 1948 form, whose royalty clauses were not substantially different from the 1962 form discussed by Phillips, provided that the lessee pay "sums equal to the value [of the gas] at the well." This was arguably ambiguous as to whether deductions from value for royalty purposes were permissible. Further, in the 1948 lease, the phrase "free of expense" was deleted from the initial paragraph of the royalty clause and the words, "free of the costs of production" were substituted, thus raising the question what constituted a "cost of production." Perhaps understandably, the 1948 form was subject to conflicting interpretations, and it is likely that the 1966 form, which included an express deduction allowing transportation costs from the field to the point of delivery, was intended to prevent this type of uncertainty.

The 1942 form used for the leases involved in these appeals presented no such ambiguity, providing that the lessee pay "sums equal to the value [of the gas] at the well, provided no gathering or other charges are made chargeable to lessor."

on the 1942 form where the State remains as lessor and where transportation deductions have been allowed. See Superior Oil Co., supra at 134.

Even if we could agree that the State's interpretation of the 1942 lease form was in conflict, we would rely on our own analysis of the lease to establish the permissibility of the transportation deduction. Ocean Drilling & Exploration Co., supra at 141. Our interpretation of this controlling language leads to the same result. A central tenet of contract construction provides that "[i]ntent is to be determined by the words of the contract, when these are clear and explicit and lead to no absurd consequences." See Henry v. Ballard & Cordell Corp., La. App., 401 So.2d 600, 605 (1981). Both the existence of the proviso clause in the 1942 form and its specific language -- "no gathering or other charges" -- persuade us to interpret it so as to prohibit deduction of any charge, including that for transportation. See Sonat Exploration Co., supra at 118. In Cox v. Hart, 260 U.S. 427 (1922), the Supreme Court stated: "The office of a proviso is well understood. It is to except something from the operative effect, or to qualify or restrain the generality, of the substantive enactment to which it is attached." Clearly, the office of this proviso was to generally prevent the deduction of charges from royalty value. This reading is amply corroborated by other language in the 1942 lease form. The lessee is expressly required to deliver royalty to the lessor "free of expense." Royalty is due on "all gas produced or saved," expressly including gas that is "utilized." Plainly, gas utilized for transportation production is included. Again, appellant has provided nothing indicating that this interpretation of the 1942 lease form terms has been found incorrect.

Appellant asserts that, in contrast to the language pertaining to gas royalties, the oil royalty clause specifically provides for the exclusion of transportation charges to the lessor, as indicated by the phrase, "provided no deductions or charges shall be made for gathering or transporting said oil to the purchaser thereof, or loading terminal, nor shall any deductions whatsoever be made chargeable to lessor." The omission of specific reference to transportation charges in the gas clause, appellant maintains, when juxtaposed to its specific inclusion in the oil clause, indicates an intent by the parties that transportation expenses incurred in the marketing of gas be deductible by lessees under the 1942 lease. Again, we disagree.

One could entertain a number of speculations as to why the drafters of the gas royalty clause in the 1942 lease did not include reference to "transportation." We are not aware that this omission has been the subject of judicial or administrative opinion at the State level. Without proof that the intent behind the language in this clause was to allow deductions for transportation costs, surmises concerning the significance of this omission remain purely speculative and do not persuade us to ignore the plain meaning of the 1942 lease terms.

Appellant has provided numerous citations to Louisiana case law in support of its contention that "market value" leases generally do not intend to exclude transportation deductions from royalty payments. This objection

is met squarely by MMS' observation that the cited case law acknowledges that the parties to a gas sales agreement are free to agree otherwise. We agree that the inclusion of the proviso language "no gathering or other charges" indicates an intent by parties signing this 1942 Louisiana form to "agree otherwise" than to a standard "market value" lease, wherein royalty basis is figured at the well without regard to the "added value" of transportation costs. See Merritt v. Southwestern Electric Power Co., *supra* at 214; Sartor v. United Gas Public Service Co., 173 So. 103, 105 (La. 1937).

Appellant contends that, as in the case of leases between private parties, inclusion of the language "at the well" in the gas royalty clause, in accordance with its meaning and usage in industry practice, indicates that the costs of transportation be borne by both lessor and lessee. Again, when read as a whole, we find the royalty language in the 1942 contract to weigh against the reading promoted by appellant. As LSMB had also evidently rejected such interpretation, we do so as well.

Accordingly, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decisions appealed from are affirmed.

David L. Hughes
Administrative Judge

I concur:

Franklin D. Arness
Administrative Judge